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SUBJECT: NETHERLANDS 2009 BUDGET: SURPLUS DESPITE ECONOMIC SLOWDOWN
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¶11. (U) SUMMARY. The Dutch economy is slowing but is well positioned to weather a downturn. The 2009 budget forecasts a 1.2 percent surplus. High gas prices, generating more tax revenue for the government's coffers, flatter this figure, but they provide a source of fiscal strength nonetheless. The government has introduced several measures in an effort to maintain the purchasing power of Dutch citizens in the face of higher inflation. END SUMMARY.

Bad News on the Growth Front

¶12. (U) The Dutch government released its EUR 179 billion (USD 254 billion) 2009 budget on September 16. The accompanying Budget Memorandum set the tone plainly: ?The Netherlands will not remain unscathed by turbulence in the international economy.? There are several risks ahead:

-- Economic growth is slowing: The Dutch government expects GDP growth to be 2.25 percent in 2008 and only 1.25 percent in 2009 (compared to 3.5 percent in 2007). The Dutch economy, with its heavy reliance on international trade flows, is vulnerable to cooling global economic activity.

-- Inflation is picking up: Inflation is expected to reach 2.75 percent in 2008 and 3.25 percent in 2009. Although this is below average Eurozone inflation levels, politicians and policy makers are preoccupied with limiting the impact of higher inflation on the average Dutchman's purchasing power. To that end, the government has taken two major steps: postponing the planned January 2009 VAT increase (from 19 to 20 percent), and committing to eliminate unemployment insurance contributions (estimated to save EUR 335 [USD 476] for the average income earner).

-- Shaky surplus: Although the projected 1.2 percent budget surpluses in 2008 and 2009 would be the envy of many EU governments, analysts have already raised the alarm that only natural gas revenues, boosted by higher commodity prices, are keeping the budget out of the red. (Note: Tax receipts from natural gas production are projected to account for EUR 10.2 billion [USD 14.5 billion], or 5.6 percent of 2009 government income. End note.) Several other one-time items also prop up the 2009 budget, including a EUR 3 billion (USD 4.3 billion) windfall in lower EU contributions to Brussels and special dividends from the government's stakes in the Schiphol airport group and the national railway company.

Good News on Fiscal Health

¶3. (SBU) The Netherlands heads into the slowdown in robust financial health compared to other EU member states. The government claims to have used recent prosperous years to prepare for an inevitable downturn. Based on a number of factors, it is hard to disagree with this self-assessment.

-- Better growth relative to EU: Despite the Netherlands' susceptibility to global trade trends, the economy is holding up well in relative terms. The latest 2008 GDP growth forecasts show the Netherlands achieving 2.25 percent versus a Euro area average of 1.3 percent.

-- Low unemployment: The unemployment rate has dropped to 4 percent this year and is expected to remain stable at that level. Dutch policy makers are using this tight labor market as an opportunity to tackle the demographic challenge of its ageing population. The 2009 budget includes new measures to boost labor force participation. For example, those who work after age 62 can earn a bonus each year they remain employed.

-- Public finances look strong: Measured against the European Monetary Union (EMU) maximum parameters of 60 percent debt to GDP and 3 percent budget deficit, the Dutch have plenty of fiscal policy headroom. The government is using its surplus to pay down national debt, which is on track to fall below 40 percent of GDP in 2009. Even after stripping out high natural gas prices and other items, the 2009 budget deficit would still be a manageable 2.1 percent.

-- Limited concern for housing prices: Mortgage growth in the Netherlands had been declining even before the credit crunch hit. Dutch Central Bank (DNB) regulators have told us they hope real estate prices will not fall sharply because the upcycle was gradual and long. Despite high loan-to-value ratios in the Netherlands, severe supply constraints in this densely populated country should

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provide a counterbalance. DNB has run stress-tests to model the effect of a 30 percent decline in home values on banks; they found the results ?quite comforting.? Dutch observers remain far more concerned about what happens in the U.S. housing market and the potential knock-on effects for global finance.

View from the Financial Sector

¶4. (SBU) In recent conversations with major Dutch financial institutions and DNB, our interlocutors have expressed concern about the global financial sector's pro-cyclical nature. DNB favors regulations that would require banks to retain more capital in good times as a hedge. This is in keeping with the Dutch government's concern for smoothing the business cycle's impact on public finance. They aim to calibrate fiscal policy by moderating spending in the good years and spending more in the down years. The 2009 budget bears the mark of this strategy.

¶5. (SBU) DNB sees Dutch economic growth and momentum slowing through 2009. Senior ING Bank and Rabobank officials have also told us they do not see the credit crisis abating in 2009. Although ING and Rabobank are comfortable with their liquidity positions (they adhere to simpler business models) and appear to be weathering the crisis, Dutch-Belgian bank Fortis faces greater difficulties, with concerns about its capital base fueling a 60 percent decline in its stock price since January 2008.

¶6. (U) Further reporting on the 2009 Dutch budget and its implications for U.S. interests, as well as the impact of the U.S. crisis on the Dutch financial sector, will follow septel.